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UNCLAS E F T O SECTION 01 OF 04 BEIJING 000263

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SUBJECT: SED SESSION THREE: SUSTAINING ECONOMIC DEVELOPMENT

REF: A. BEIJING 259

[1](#)B. BEIJING 262

[1](#)1. (SBU) Summary: In the December 14 Strategic Economic Dialogue (SED) session on sustaining economic development, Federal Reserve Chairman Bernanke discussed how a flexible exchange rate will help balance China's economy. National Development and Reform Commission (NDRC) Chairman Ma Kai raised the structural challenges that China faces and countered that relaxing United States export controls would help reduce China's trade surplus with the United States. Commerce Secretary Gutierrez added that China could both increase consumption and reduce its trade surplus by increasing market access for foreign services. People's Bank of China (PBOC) Governor Zhou Xiaochuan said that China's financial reforms will proceed gradually to ensure steady growth and financial stability. Health and Human Services Secretary Leavitt discussed the efficiencies of setting

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common standards. Minister of Labor and Social Security Tian Chengping and Labor Secretary Chao both expressed support for greater cooperation on pension reform. End Summary.

Chairman Bernanke on Balancing China's Economy

[1](#)2. (SBU) Federal Reserve Chairan Benjamin Bernanke explained the risks of Chna's imbalanced growth to the participants in the third session of the Strategic Economic Dialogue (SED). He noted that investment and net exports are too high and consumption is too low. Capital misallocation runs the risk of creating new non-performing loans (NPLs) and weakening financial institutions. Chairman Bernanke encouraged China to increase public spending on pensions and healthcare and expand individuals' access to private insurance to reduce

precautionary savings and raise consumption. An appreciation of the renminbi (RMB) will change relative prices, reducing incentives to invest in the export sector.

13. (SBU) Chairman Bernanke noted that limited RMB flexibility inhibits the central bank's ability to adjust interest rates to maintain price stability. Due to China's high savings rate, the central bank has been able to mop up liquidity without a large increase in interest rates, but this will become increasingly difficult as the stock of sterilization bonds continue to grow. Moreover, with a rigid exchange rate, as China liberalizes its capital account, the effectiveness of monetary policy will be hampered.

China's Economy Like Japan's in the Seventies

14. (SBU) In response to observations by Treasury Secretary Henry Paulson on the lessons for China from Japan's experience, Chairman Bernanke noted that erratic monetary policy and an unwillingness to deal resolutely with NPLs in the financial sector, not the yen's appreciation following the Plaza Accord in the mid-1980s, had contributed to Japan's stagnation in the 1990s. An even better lesson can be drawn from Japan's experience in the early 1970s. During that time, Japan's excessive focus on exchange rate stability led to rapid money supply growth, followed by inflation, excessive investment and ultimately recession.

NDRC: Rapid Investment Growth is Part of Industrialization,
but Investment Slowing Down

15. (SBU) Chairman of the National Development and Reform Commission (NDRC) Ma Kai said rapid investment growth is inevitable and rational for China, which is currently

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undergoing urbanization and industrialization. Wary of excess investment, the Chinese Government will work to moderate its growth and raise returns on investment by improving the allocation of investment. For example, China will promote investment in sectors that conserve energy and raise energy efficiency.

Chinese Government Measures to Raise Consumption

16. (SBU) To promote consumption, Chairman Ma said the government is trying to raise incomes of farmers and low-income urban dwellers as well as promote services (which are less investment intensive). Ma acknowledged that insufficient access to health insurance also led to high precautionary savings. Widening income inequality also contributes to high savings. The government has introduced the following measures to raise rural and low-income urban dwellers' incomes: 1) abolishing rural taxes, 2) providing subsidies to farmers, 3) providing subsistence housing for low-income urban dwellers, 4) introducing a minimum wage in rural areas, 5) improving medical and social security benefits, and 6) raising government expenditures on cultural activities, such as tourism.

17. (SBU) China does not pursue a trade surplus, Chairman Ma added, and only in the recent two years has China experienced surpluses that are large relative to its economy. China's trade with the United States is mutually beneficial and complementary. Ma hoped that the United States would relax controls on high-tech exports to reduce the trade imbalance.

PBOC: Financial Reforms Will Proceed Gradually to Ensure
Steady Growth

18. (SBU) Zhou Xiaochuan, Governor of People's Bank of China (PBOC), said that the Chinese Government places priority on

economic stability and steady growth. The PBOC has made better use of indirect monetary policy instruments and more market based interest rates and the RMB has appreciated around six percent against the USD since July 2005. He highlighted other structural adjustments, such as growth in consumer credit, mortgages and auto loans. Governor Zhou said that China will deregulate financial markets gradually to maintain economic and financial stability.

Gutierrez: Further Discussion on High-Tech Exports in JCCT

19. (SBU) Commerce Secretary Carlos Gutierrez said that the United States' goal to reduce its trade deficit is to export more, not import less. Secretary Gutierrez noted that the United States and China had widely different assessments of the impact of high technology export controls on trade imbalances and suggested they discuss this in the High-Tech Working Group under the Joint Commission on Commerce and Trade. He added that China could both raise consumption and reduce its trade surplus through greater market access for foreign services. Assistant Secretary of State Daniel Sullivan added that another issue that prevents American companies from exporting high-tech equipment is China's inadequate IPR protection.

MOH: China to Strengthen Health Services

10. (SBU) Minister of Health Gao Qiang said the Chinese Government's major goal is to strengthen health services by:
1) closing the health services gap among regions (and

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particularly between rural and urban areas), 2) improving the quality of health services, 3) establishing different medical insurance schemes for different areas, 4) improving the financial health and supervision of hospitals, 5) providing safe and inexpensive medicines, and 6) diversifying health care services by encouraging investment in medical institutions.

Secretary Leavitt: Technical Standards Can Be Trade Barriers

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11. (SBU) Health and Human Services Secretary Michael Leavitt said he had just toured parts of rural China and recognized China's varying levels of health services. Secretary Leavitt noted that varying technical standards for medical coding, software, and the environment could be significant barriers to trade and to the efficient provision of health care. He commended examples of price transparency at Chinese hospitals he had recently visited.

MOLSS: Expanding the Coverage of Pension and Health Insurance Schemes

12. (SBU) Minister of Labor and Social Security Tian Chengping said the government is expanding the coverage of pensions to reduce household savings. Although China started late in developing its pension scheme, pension coverage for workers has been growing. In urban areas, the Chinese Government plans to cover an additional 10 million people per year starting in 2006 so that 50 million more will be covered by 2010. Students, unemployed, and retired elderly people currently have no health insurance coverage, but China plans to launch pilot projects in 2007 so that all residents in selected urban areas will have access to health insurance.

Secretary Chao: Greater Cooperation on Pension Reform

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¶13. (SBU) Labor Secretary Elaine Chao said that strengthening the social safety net will lead to more balanced growth. Secretary Chao stressed the important roles of both public

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and private pensions. She noted the importance for both countries to cooperate on this issue.

Participants List

¶14. (U) United States Delegation:

- Henry Paulson, Secretary of Treasury
- Clark T. Randt, Jr., United States Ambassador to China
- Michael Leavitt, Secretary of Health and Human Services
- Samuel Bodman, Secretary of Energy
- Carlos Gutierrez, Secretary of Commerce
- Elaine Chao, Secretary of Labor
- Susan Schwab, United States Trade Representative
- Stephen Johnson, Administrator of the Environmental Protection Agency
- Benjamin Bernanke, Chairman of the Federal Reserve
- James Lambright, Chairman and President of Ex-Im Bank
- Daniel Sullivan, Assistant Secretary, Department of State
- Andrew Steinberg, Assistant Secretary, Department of Transportation
- Matthew Slaughter, Member of the Council of Economic Advisors

¶15. (U) Chinese Delegation:

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- Wu Yi, Vice Premier
- Jin Renqing, Minister of Finance
- Ma Kai, Chairman of National Development and Reform Commission
- Xu Guanhua, Minister of Science and Technology
- Tian Chengping, Minister of Labor and Social Security
- Liu Zhijun, Minister of Railways
- Li Shenglin, Minister of Communications
- Wang Xudong, Minister of Information and Industry
- Bo Xilai, Minister of Commerce
- Gao Qiang, Minister of Health
- Zhou Xiaochuan, Governor of People's Bank of China
- Li Changjiang, Administrator of General Administration of Quality Supervision, Inspection, and Quarantine
- Zhou Shengxian, Administrator of State Environmental Protection Administration
- Zhou Wenxiong, Chinese Ambassador to the United States
- Xu Shaoshi, Deputy Secretary-General, State Council
- Yang Jiechi, Senior Vice Minister, Ministry of Foreign Affairs
- Zhang Xiaoqiang, Vice Chairman, National Development and Reform Commission
- Li Yong, Vice Minister, Ministry of Finance
- Yi Xiaozhun, Vice Minister, Ministry of Commerce
- Hu Xiaolian, Vice Governor, People's Bank of China
- Li Ruogu, Chairman of China Export-Import Bank

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